

**BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON DC 20268-0001**

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POSTAL RATE AND FEE CHANGES, 2000

) Docket No. R2000-1
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**INITIAL BRIEF
OF
PARCEL SHIPPERS ASSOCIATION**

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Dated: September 13, 2000

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STATEMENT OF THE CASE AND STATEMENT OF THE PARCEL SHIPPERS ASSOCIATION

It is the position of the Parcel Shippers Association (PSA) that the proposed Parcel Post rates are inequitable because they are based on the R97-1 rates, rates which were much higher than the Commission intended due to the Postal Service's grossly underestimated volume and revenue projections.

Had the Postal Service correctly reported revenues and volume of Parcel Post in R97-1, it is reasonable to assume that the Postal Rate Commission would have recommended a rate increase for Parcel Post no greater than the system-wide average increase, given the fact that Parcel Post is the second most price elastic class of mail, and given the fact that, with no rate increase at all, Parcel Post, in fact, met the Commission's cost coverage recommendations.

Based on the corrected RPW for Parcel Post, a rate increase in R97-1 that simply matched the overall average increase in R97-1, coupled with a rate increase in this proceeding that equalled the 6.4% overall average increase proposed, would produce a Parcel Post rate schedule that would be 4% less than the current rates.

In this proceeding the proposed cost coverage for Parcel Post of 115.1% is well above the coverage recommended by the Commission in the last proceeding. There is no case made to increase coverage above the 109% recommended in R97-1.

There is fierce competition with UPS for all parcels. Because UPS is unregulated, and not required to divulge information to any regulatory body, including the Postal Rate Commission, it is not possible to know the extent of the price competition between the Postal Service and UPS. We do know that many large parcel

shippers have special deals with UPS that are secret and that undercut current Parcel Post rates. Any increase in Parcel Post rates will simply provide UPS with an opportunity to increase its own prices without suffering volume losses, and thereby damage competition.

It is clear that the Postal Service's revised methodology for measuring the revenue pieces and weight (RPW) for Parcel Post is an improvement and provides, for the first time, accurate revenues and pieces for parcels. The new methodology combines both the BRPW and the DRPW. The use of the DRPW-only system in R97-1 led to an understatement of revenues of almost 125 Million dollars and a corresponding understatement of parcel volume by almost 50 million pieces. This of course led to a gross exaggeration of the average unit cost of Parcel Post. (Cost divided by volume)

Contrary to UPS claims, an analysis of postage statement-level data indicates that BRPW data do not contain significant errors. Also the trial balance revenue for FY-99, PQ 3 and 4, amply demonstrates that the BRPW estimate of permit imprint Parcel Post is more accurate than the DRPW-only estimate. The evidence also shows the inclusion of less than 1 pound parcels mailed at Parcel Post rates does not cause an overstatement of the BRPW permanent imprint Parcel Post revenue. Also, the UPS suggestion that permit pieces being recorded as metered pieces in DRPW cause significant bias is unfounded. It is quite unlikely that there was much, if any, confusion on the part of data collectors as to whether something was a permanent imprint or a metered piece, as is obvious to anyone who looks at two such pieces.

It is quite likely that the gross understatement of volumes and revenues resulting from the DRPW only system is a result of a misunderstanding on the part of data

collectors as to just what they were to count. A number of the DRPW data collectors may have considered all Standard Mail (B) permit imprint mail to be ineligible for sampling. If just one in five data collectors had this misunderstanding it would account for the entire missing volume and revenue.

The Postal Service method for distributing city carrier elemental load costs to parcels on the basis of pieces rather than weight is the more correct method and the Commission should continue that methodology. No one believes that it costs ten times as much to load an average Standard B parcel as an average Standard A parcel just because the Standard B parcel weighs ten times as much as the Standard A parcel on average. Also, the Postal Service's attribution of cost for the so called "Exclusive Parcel Post Routes" is also correct. UPS simply failed to check what is actually being delivered on "Exclusive Parcel Post Routes." Only a minority are actually Parcel Post pieces.

The correct method of estimating drop-ship cost avoidance is that advocated by PSA witness Glick. Mr. Glick's model assumes that DBMC parcels incur a smaller amount of outgoing, non-BMC mail processing cost than do non-DBMC parcels. Mr. Glick is able thereby to correct the flaw in the Postal Service model without introducing the additional errors in the United Parcel Service model.

The Postal Service cost model for destination delivery unit parcels is correct in its assumption that these parcels avoid all unloading and shake out costs at the DDU, contrary to what UPS avers. PSA witness Wittnebel, a major shipper of DDU parcels, confirmed the Postal Service's assumption. The only error in the Postal Service model

is that, in estimating DDU cost avoidance, it failed to make the CRA adjustment. Failing to do so has the known impact of underestimating cost avoidance.

The UPS proposal that this one rate category, singled out from all others, should have its own implicit cost coverage because UPS claims the service is comparable to priority mail service, is a suggestion that, generally applied, would lead to chaos in the coverages for various rate categories. Of course, to the extent that DDU parcels are receiving comparable delivery service as priority mail, it is because the DDU shippers are performing a number of functions at their own expense and bring the parcel to the delivery unit, unlike priority mail parcels. Once again, typical of UPS comparisons, it is apples and oranges.

The proposed rates for oversized parcels are excessive, due to the erroneous estimate of the cube of oversized parcels. The Postal Service, which has relatively few oversized parcels, largely because of the excessively high rate, used samples that are too small for credible estimates. In the real world, PSA witnesses who ship oversized parcels, using other carriers, confirmed that the Postal Service overstated the average cube by more than 25 percent.

The Postal Service has not justified an 80 percent increase in the Standard A surcharge. Neither law nor policy requires each type of mail within a rate category to fully cover its costs. The Postal Service is attempting to require Standard A parcels to meet the requirements of a separate subclass, where that subclass is required to recover 100 percent of its attributable costs. In fact, Standard A parcels, even if one credits the Postal Service's very questionable cost data, cover 80 percent of their costs without this egregious 80 percent increase in the surcharge. Without a better

justification, an 80 percent increase in the rate element is in contravention of criterion four of the Act.

The Service's proposal to extend bar code discounts to Standard A parcels is only fair; the cost avoidances are just the same as they are for Standard B parcels.

The proposed increase for Priority Mail is excessive. Priority Mail's already high cost coverage argues against a 15 percent increase just so the Postal Service can foolishly exact what it believes the traffic will bear. The Postal Service is wrong; the traffic will not bear that increase; and they will lose business to the competition. The consequences of this are that the consumer will be the ultimate victim; the competitors will raise their rates, will take business away from the Postal Service, and competition will suffer.

Finally, the Postal Service has exaggerated the amount of revenue it requires in this case, largely because it has exaggerated the contingency it needs. In the shorter rate cycles we are now in there is no justification for a contingency so large.

I. OVERALL THE PROPOSED PARCEL POST RATES AND COVERAGE ARE INEQUITABLE BECAUSE THEY ARE BASED ON R-97-1 RATES THAT WERE MUCH HIGHER THAN THE RATE COMMISSION INTENDED DUE TO THE GROSSLY UNDERESTIMATED VOLUME AND REVENUE PROJECTIONS FOR PARCEL POST.

A. What Appear To Be Small Rate Increases For Parcel Post Must Be Seen In The Context Of The Grossly Understated Volumes And Revenues That Formed The Basis Of The Commission's R97-1 Parcel Post Rate Recommendations.

In Docket R97-1, while accurately estimating the unit costs for the test year, the Postal Service underestimated the volume of Standard (B) zone-rated parcels by almost

50 million pieces, and underestimated the revenues by 124.3 million dollars. Tr. 29/14146 (Zimmerman). Had the actual revenue and volumes been used, the before-rates cost coverage in the test year for Parcel Post would have been 122 percent, using Postal Service methodology, or 112.4 percent using the PRC's costing methodology. Thus, with no increases whatsoever Parcel Post would have had a 3.4 percent higher cost coverage than the PRC, using PRC methodology, recommended in R97-1. Id. A zero increase in Parcel Post would still have exceeded the recommended coverage of 109 percent by 3.4 percent. Id. at 14147. While it may be conjecture, it seems a certainty that the PRC, had it known the true volume and revenue figures for Parcel Post, would never have recommended a 12.3 percent rate increase for the second most price elastic sub-class of mail in a proceeding where the average recommended rate increase was 2.5 percent.

Given the actual coverages for Parcel Post, then and now, it is reasonable to argue that Parcel Post rates should be no more in the test year after rates than they would be if Parcel Post were to have been given the average rate increase in R97-1 and the average increase in the current case, for a total combined increase of 8.9 percent. (6.4 percent + 2.5 percent = 8.9 percent). Were that to be the case, it would require, as witness Zimmerman points out, a 4 percent reduction in current Parcel Post rates, not an increase. Id.

B. The Cost Coverage for the Standard (B) Parcel Post Subclass Should Be Less Than Proposed by the Postal Service.

The Postal Service appears to have no justification for its proposed increase in Parcel Post cost coverage above that recommended by the Commission in Docket No.

R97-1. Tr. 29/14149 (Zimmerman). For this reason and others discussed below, the Postal Service's proposed coverage should be ignored. This section discusses the reason why the Commission should recommend a cost coverage lower than proposed.

First, as PSA witness Zimmerman (PSA-T-1) notes in his testimony, the Postal Service had no basis for proposing a cost coverage of 115.1 percent:

It is painfully evident that the Postal Service's recommended coverage of 115.1% is a mere accident of how the rates came out. USPS witness Mayes' initial recommendation was for 114% cost coverage, because she thought that was what witness Plunkett's rates produced. When informed that she was mistaken about that, and that in fact witness Plunkett's rates produced a 115.1% cost coverage, witness Mayes promptly changed her testimony to say that she was recommending 115.1%, rather than 114%. In other words, her coverage recommendation was whatever the rates happened to be. Tr. 29/14148-14149 (Zimmerman).

Because the Postal Service has no justification for its increased coverage, the Commission should recommend the same 109 percent cost coverage that it recommended in Docket No. R97-1.

Second, as already noted, had it not been for the staggering error in the DRPW-only Parcel Post RPW estimate used in Docket No. R97-1, current rates for the Standard (B) Parcel Post subclass would be much lower. This certainly argues in favor of a small rate increase and a low cost coverage in this proceeding.

Third, the Postal Service-proposed rates for the Standard (B) Parcel Post subclass result in an average rate increase for the subclass that is significantly higher than the 1.3 percent increase that USPS witness Mayes (USPS-T-32) presents. In his attachments, USPS witness Plunkett (USPS-T-36) shows that the implementation of USPS-proposed rates would increase the average revenue per piece for the Standard

(B) Parcel Post subclass by 2.3 percent, from \$3.165 in the Test Year Before Rates to \$3.238 in the Test Year After Rates. USPS-T-36, Attachment K. This 2.3 percent increase in average revenue per piece occurs despite the fact that the TYAR mail mix is more heavily drop-shipped than the TYBR mail mix. USPS-T-36, Attachment D, rows (15)-(18). Therefore, the proposed rates will have a larger impact on parcel shippers than was originally presented. This certainly supports recommending a lower cost coverage for the Standard (B) Parcel Post subclass than proposed by the Postal Service.

Fourth, the Postal Service has characterized Parcel Post as follows: A lower intrinsic value of service; lower delivery priorities; not good security in delivery; lack of free services, such as insurance, tracking and confirmation; and an own price elasticity above 1.0 indicating a low economic value of service. USPS-T-32, pp. 40-41 (Mayes).

Finally, while Mr. Zimmerman does not claim there is necessarily a cause and effect relationship between cost coverages and Parcel Post volume, he does point out that, since the very first rate case, the highest cost coverages for Parcel Post coincided with dramatic declines in volume. As Library Reference H-117 shows, at its low point in 1989 Parcel Post had lost 79 percent of its 1970 volume. Tr. 29/14148 (Zimmerman) The rejuvenation of Parcel Post coincided with the lowest cost coverages beginning with Docket R90-1 through Dockets R94-1 and R97-1. To quote from the D.C. Circuit's review of the R97-1 Decision: "...the Commission has consistently, and reasonably, held that it [Factor 5] authorizes a reduction in rates to maintain the position of the Postal Service as a competitor in the mail delivery industry." *United Parcel Service, Inc.*

v. U.S. Postal Service, 184 F.3d 827, 845 (D.C. Cir. 1999). The Commission should continue its policy of recommending lower coverages for Parcel Post.

II. THE POSTAL SERVICE FACES FIERCE COMPETITION IN THE PARCEL DELIVERY MARKET.

As PSA witness Zimmerman points out, although USPS is painted as a monopoly, in fact, there is open competition for every single parcel carried by the Postal Service. The package market is one that is of increasing importance to the Postal Service as well as to its customers. From the customer's perspective, that market is divided into expedited and ground parcel delivery. However, for the Postal Service, this is not possible because of its tightly classified and regulated structure. Tr. 29/14131 (Zimmerman)

Dr. Tolley divided the conventional ground transportation package service into various categories. He divided it among UPS, FedEx/RPS, and the Postal Service. USPS-T-6, chart 4, p. 154. As was brought out at the hearing, for some reason Dr. Tolley did not correctly add the various volumes of ground transportation. The correct total is 4 billion, 809 million, rather than 4 billion, 183 million. Tr. 29/14175. If one subtracts, as Dr. Tolley did, the Standard A parcels and non-zone rated Standard B parcels, that describes a market of 3 billion, 235 million, of which Parcel Post constitutes 10 percent.

UPS would have the Commission believe that it is all just one big package market, even including some 550 million First-Class parcels (IPPS), although Dr. Tolley did not include such packages in his total ground parcel market. Tr. 29/14175-9 There is no testimony by any witness that First-Class parcels are even what would be

conventionally understood to be a parcel, let alone part of one large and indissoluble market, as suggested by UPS. In fact PSA witness Zimmerman said that in the real world, and he is a practitioner in that world, parcel shippers would not consider First-Class "parcels" as part of that market. Tr. 29/14179

As witness Zimmerman pointed out, the Postal Service's 10 percent share of this market, if it is to grow, must do so through competitive drop ship rates, thereby avoiding high cost and inefficient postal labor, and it must also improve the level and consistency of its service. Tr. 29/14132-3 Mr. Zimmerman also pointed out that it is simply not possible to compare any published UPS tariff with that of the Postal Service and determine thereby whether Parcel Post rates are higher or lower. This is because large numbers of big parcel shippers who use UPS have secret contract rates that bear no relationship to the published UPS tariffs that may exist from time to time. He testified there are a number of PSA members who have such arrangements. Tr. 29/14133

Mr. Zimmerman pointed out that, for a large parcel shipper such as his company, there are three distinct markets: overnight; two to three days service; and deferred or ground transportation service. In dealing with United Parcel Service these companies do not have to deal with various parcel weights and sizes and varying content descriptions; they are free to, and do, negotiate a blended rate against guaranteed volumes. They do this with FedEx and with UPS. However, they cannot make that deal with the United States Postal Service. Mr. Zimmerman pointed out that UPS will even make a deal that combines the three distinct levels of service all under one umbrella. Id. It is impossible for USPS to compete with that kind of flexibility and to pretend that the package market is just one large market. The reality is, for both postal customers

and for Postal Service competitors, Postal Service package markets must be viewed as distinct and separate, and for that reason the Postal Rate Commission also has to treat them as distinct markets. Id. And as witness Zimmerman also pointed out, even when the parcel shipper does not have a special deal with UPS, Parcel Post may not be an alternative, despite lower rates, because of other real costs, including inferior service. Id. at 14134.

Witness Zimmerman also points out that the competition the Postal Service has been able to give to UPS during the last 10 years because of the competitive rates that the Commission has recommended in that time have paid off for both consumers and competition. And it has not hurt UPS, which, as Mr. Zimmerman pointed out, had just posted record quarterly profits. Id. We urge the Commission to continue to apply Factor Four as an admonition to protect competition not a particular individual competitor.

III. THE JOINT BULK REVENUE, PIECES AND WEIGHT/DOMESTIC REVENUE, PIECES AND WEIGHT (BRPW/DRPW) SYSTEM THAT THE POSTAL SERVICE USED TO ESTIMATE PARCEL POST REVENUE, PIECES, AND WEIGHT IS MORE ACCURATE THAN DRPW, THE SYSTEM THAT THE POSTAL SERVICE USED IN PAST CASES.

In this case, the Postal Service proposes an improved method for estimating revenue, pieces, and weight (RPW) for the Standard (B) Parcel Post subclass. This improved method estimates RPW for permit imprint Parcel Post, which is primarily bulk mail, based upon a census of postage statements from automated offices. Because this estimating method is used for bulk mail, it is referred to as the Bulk RPW (BRPW) method. The Postal Service then used a sampling system, referred to as the Domestic RPW (DRPW) system, to estimate RPW for the remainder of Parcel Post, which is

primarily single-piece mail. The Postal Service generally uses the DRPW sampling system to estimate RPW for mail that is not entered in bulk and therefore is not accompanied by a postage statement.

Where possible, the Postal Service uses the BRPW system because it is not subject to sampling error. Tr. 43/18788 (Prescott). PSA agrees that because BRPW is based upon a census of postage statements at automated offices and because it avoids the types of data collection error that infect DRPW, BRPW is a superior method for estimating RPW for permit imprint Parcel Post. For this reason and others described below, the Postal Service's joint use of BRPW to estimate permit imprint Parcel Post RPW and DRPW to estimate non-permit imprint Parcel Post RPW is a significant improvement over the Postal Service's old method of estimating bulk and single-piece Parcel Post RPW using the sample-based DRPW system.

The sections below show that the BRPW system is not infected by any significant errors, explain why Trial Balance revenue for FY 1999, Postal Quarters (PQ) 3 and 4, indicates that the BRPW estimate of permit imprint Parcel Post is more accurate than the DRPW estimate, discuss why speculations by UPS witness Sellick (UPS-T-4 and UPS-ST-1) about the accuracy of the joint BRPW/DRPW estimate of Parcel Post RPW are inconsistent with the facts, and describe a significant flaw in the old DRPW-only method for estimating Parcel Post RPW.

A. UPS Witness Sellick's (UPS-ST-1) Analysis of Postage Statement-Level Data Indicates That BRPW Data Do Not Contain Any Significant Errors

To test whether the BRPW system contained any significant flaws, Mr. Sellick ran a revenue tolerance test on a Postal Service data base (USPS-LR-I-194) containing FY 1998 permit imprint Parcel Post RPW data disaggregated by postage statement, rate category, and zone. Of the more than 600,000 detailed records contained in this database, only 545 failed the check. Tr. 37/16956 (Sellick); Response to PSA/UPS-ST1-1 (Sellick) Tr. 46-B/20652-3 This represents an unweighted error rate of less than 0.1 percent, a very small rate indeed.¹ Response to PSA/UPS-ST1-1 (Sellick) Id. As illustrated by Table 1 below, the piece-weighted and revenue-weighted error rates are even smaller. To put this error rate into context, the DRPW estimate of FY 1998 permit imprint Parcel Post pieces is 21 percent less than the BRPW estimate. Tr. 41/18069 (Glick).

Table 1. Error Rate in BRPW Data Base

		Number of Records	Number of Pieces	Revenue
Nonsensical	[1]	545	46,300	422,001
Total	[2]	657,156	236,363,186	623,770,930
Error Rate	[3]=[1]/[2]	.083%	.020%	.067%

[1], [2], [3] Response to PSA/UPS-ST1-1

¹ As noted by PSA witness Glick (PSA-RT-1), other analyses performed by Mr. Sellick showed similarly small error rates. Tr. 41/18063-18067 (Glick).

B. FY 1999, PQ 3 and 4 Trial Balance Revenue Show That the BRPW Estimate of Permit Imprint Parcel Post RPW Is More Accurate Than the DRPW Estimate.

All parties in this proceeding agree that when a unique permit imprint Trial Balance revenue account exists, it represents the most accurate estimate of permit imprint revenue for the subclass. In his direct testimony, Mr. Sellick stated: "The trial balance adjustment [, which adjusts the BRPW estimate of permit imprint Parcel Post revenue to equal the revenue in the trial balance,] ensures that BRPW estimated revenue does not exceed or understate actual revenues (emphasis added)."

Tr. 31/15038 (Sellick). In response to a Presiding Officer's Information Request (POIR), Postal Service witness Hunter stated: "A trial balance can be a useful tool for improving the quality of BRPW results by controlling to known amounts of revenue (emphasis added)." Response to POIR #17, Question 5 (Hunter) Tr. 46-D/21233.

In the case of the Standard (B) Parcel Post subclass, however, a unique permit imprint revenue account only became available in FY 1999, PQ 3 and 4. Therefore, the Postal Service was unable to adjust the BRPW estimate of permit imprint Parcel Post revenue to "known amounts of revenue" in the trial balance account for FY 1998 and FY 1999, PQ 1 and 2.

The availability of a unique permit imprint Parcel Post trial balance for FY 1999, PQ 3 and 4, therefore serves two purposes. First, it allows the Postal Service to make a trial balance adjustment that "ensures that [FY 1999, PQ 3 and PQ4] BRPW estimated revenue does not exceed or understate actual revenues." Tr. 31/15038 (Sellick). Second, it allows a check on whether the lack of a trial balance adjustment in FY 1998

and FY 1999, PQ 1 and 2 would have overstated permit imprint Parcel Post revenue or understated it.

Specifically, because permit imprint Parcel Post trial balance revenue was 6.3 percent higher than the unadjusted BRPW estimate in FY 1999, PQ 3 and 3.5 percent higher in FY 1999, PQ 4,² Tr. 37/16969 (Sellick), not making a trial balance adjustment for these two quarters would have understated permit imprint Parcel Post revenue. Tr. 37/16970 (Sellick). Because not performing a trial balance adjustment to FY 1999, PQ 3 and 4 BRPW estimates would have understated permit imprint Parcel Post revenue in each of these two quarters, it is likely that not having performed a trial balance adjustment in FY 1998 and FY 1999, PQ 1 and 2 resulted in an underestimate of revenues for these periods as well.³

For this reason, PSA recommends that the Commission adjust the BRPW estimate of permit imprint revenue for FY 1998 and FY 1999, PQ 1 and 2 using the average of the trial balance adjustment factors (approximately 1.05) for FY 1999, PQ 3 and 4, rather than the interim adjustment factor. At a minimum, the fact that permit imprint Parcel Post trial balance revenue for FY 1999, PQ 3 and 4 was higher than the BRPW estimate of permit imprint estimate suggests that the much lower DRPW estimate of permit imprint Parcel Post revenue for FY 1998 is clearly wrong.

² Before the trial balance account was available, the Postal Service did apply an interim adjustment factor of 1.009 to the BRPW estimate. However, because this factor was less than the trial balance adjustment factors for each of these quarters, 1.063 and 1.035, the lack of a trial balance adjustment factor understated revenue even after taking the interim adjustment into account. Tr. 37/16970 (Sellick).

³ This is particularly true because no party has provided any evidence that the trial balance adjustment factors for PQ 3 and 4 are unrepresentative of those for PQ 1 and 2.

C. Mr. Sellick's Speculations Regarding Potential Biases in the Joint BRPW/DRPW Estimate of Parcel Post RPW Lack Merit.

1. Mr. Sellick is Wrong in Stating That Parcels Weighing Less Than One Pound Which Are Mailed at Parcel Post Rates Overstate the BRPW Estimate of Permit Imprint Parcel Post Revenue.

In his supplemental testimony, Mr. Sellick argued that because Standard (A) parcels weighing less than one pound can be mailed at Standard (B) Parcel Post rates if the Parcel Post rate is lower, BRPW will overstate Parcel Post revenue. Tr. 37/16957 (Sellick). This section explains that only a very small proportion of bulk Standard (B) Parcel Post parcels in FY 1998 weighed less than one pound and an even smaller proportion in FY 1999 weighed less than one pound; discusses why single-piece Parcel Post parcels weighing less than one pound would not have had a significant impact on BRPW estimates; and describes why, when parcels weighing less than one pound were mailed at Parcel Post rates starting in January 1999 (and perhaps earlier), it was appropriate to record their revenue as Parcel Post revenue.

First, PSA witness Glick asked several parcel shippers whether they mailed any parcels weighing less than one pound at Parcel Post rates in FY 1998 or FY 1999. As he described in his testimony, these shippers indicated that this practice occurred very infrequently in FY 1998 and was discontinued altogether after the implementation of Docket No. R97-1 rates:

Most of them indicated that they hadn't done so. A couple mailers indicated that a very small portion (less than two percent) of the parcels they mailed at Parcel Post rates in FY 1998 weighed less than one pound. However, after the implementation of Docket No. R97-1 rates, these mailers discontinued this practice. This is because, with the implementation of Docket No. R97-1 rates, the Domestic

Mail Manual (DMM) no longer allows Standard (A) mail to be mailed at Parcel Post rates. Specifically, the DMM only allows Standard (A) mail to be mailed at Standard (B) mail rates if the Standard (B) mail rate is less than the Standard (A) mail rate. Domestic Mail Manual, Issue 54, Section E612.4.6. As noted above, Parcel Post rates are uniformly higher than Standard (A) rates. Tr. 41/18064-18065 (Glick).

Second, while it is possible that less-than-one-pound single-piece parcels were mailed at Parcel Post rates in FY 1998, this would have had a very small impact (if any) on permit imprint Parcel Post revenue. This is because single-piece parcels are generally not permit imprint pieces and therefore are generally counted by DRPW, not BRPW. Furthermore, the Standard (A) single-piece subclass was eliminated in January 1999, thereby avoiding this potential issue altogether. Response to PSA/UPS-ST1-2, Tr. 46-B/20654-56.

Third, Mr. Sellick suggests that it is always wrong for the revenue for parcels weighing less-than-one pound to be recorded as Parcel Post parcels. Tr. 37/16957. This contention is incorrect. It would only be inappropriate for the revenue for these parcels to be recorded as Parcel Post revenue if the cost for these parcels was recorded as Standard (A). As USPS witness Prescott testifies (USPS-RT-26), this was not the case starting in January 1999 and perhaps earlier. Specifically, he stated:

It is not my role to elucidate mail classification policy, but I would point out that with Docket No. R97-1 implementation (January 1999), the Postal Service started requiring Standard Mail (A) paid at Standard Mail (B) rates to be endorsed with the appropriate Standard Mail (B) marking. Thus, *ipso facto*, from the Postal Service's perspective these items should be considered Standard Mail (B) and the PERMIT System's procedures are correct: the FY 1998 estimates do not "...incorrectly count some unknown portion of Standard (A) parcels as Parcel Post" (UPS-ST-1 at 7, lines 7-8) and the costs of such mail are also properly accounted for as Standard Mail (B). Tr. 43/18804 (Prescott).

Finally, if Standard (A) parcels being recorded as Standard (B) parcels had caused major problems in BRPW, Mr. Sellick's analysis of Plant-Verified Drop Shipment forms (Forms 8125) to assess whether any parcels weighing less than one pound were mailed at Standard (B) rates would have shown this to be an issue. As Mr. Glick notes in his testimony, Mr. Sellick's analysis of Forms 8125 showed that this was not a problem at all. Tr. 41/18066-18067 (Glick).

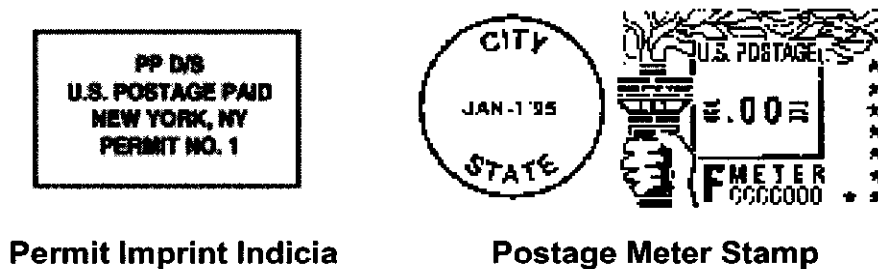
2. It Is Very Unlikely That Permit Imprint Pieces Being Recorded as Metered Pieces in DRPW Caused Significant Bias.

In his direct testimony, Mr. Sellick argues that, if DRPW data collectors incorrectly recorded permit imprint pieces as metered pieces, then both the DRPW and BRPW would count the piece and that this would result in double counting. Tr. 31/15045-15048 and 15169-15171 (Sellick). This is not likely to be an issue for two reasons. First, as Mr. Glick notes, if this were likely to occur, then the reverse error would occur as well, thus offsetting the impact:

However, Mr. Sellick fails to take into account that if such errors occur, then they are likely to occur in the reverse direction also. The reverse error would result, for example, in some metered Parcel Post pieces being incorrectly categorized as permit imprint pieces. As a result, these metered Parcel Post pieces would not be counted by either the BRPW system or the DRPW system. Mr. Sellick acknowledged in cross-examination that this reverse error would lead to under-counting of Parcel Post. Tr. 31/15171-15173 (Sellick). Thus, the general type of data collector errors that Mr. Sellick discusses could lead to some double-counting and some under-counting. On balance, these effects would tend to cancel each other out, which would reduce the impact of this issue (if it is an issue at all) on Parcel Post estimates. Tr. 41/18067-18068 (Glick).

Second, as Mr. Prescott notes, "my experience is that summary DRPW data by indicia aligns well with that from other Postal data sources." Tr. 43/18796 (Prescott). This is probably because correctly identifying a permit imprint piece is not a difficult task. As illustrated by Figure 1 below, visual inspection of indicia on permit imprint pieces and metered pieces confirms that there are significant differences between metered and permit indicia that would allow a data collector to easily distinguish between the two:

Figure 1. Sample Markings on Permit Imprint and Metered Pieces



D. The Postal Service Has Provided a Reasonable Explanation of why the Old DRPW-Only Estimate of Parcel Post RPW Is Wrong and Therefore Should Not Be Used.

As described above, Mr. Sellick has provided no reason to believe that there are any significant flaws in the joint BRPW/DRPW system for estimating Standard (B) Parcel Post RPW. On the other hand, the Postal Service has identified a significant flaw in the DRPW-only method for estimating Parcel Post RPW. Specifically, Mr. Prescott explains the problem with the old DRPW-only estimate:

At a series of Statistical Programs conferences, field Statistical Programs managers and data collectors were consulted on the data discrepancy [between the old DRPW-only estimate of Parcel Post RPW and the improved BRPW/DRPW estimate]. The shared consensus was that some DRPW data collectors were considering all Standard Mail (B) permit imprint mail to be ineligible for sampling. In other words, some data collectors were erroneously treating permit imprint Parcel Post the same way they treated permit imprint BPM which is the only Standard Mail (B) category ineligible for DRPW sampling. (The fact that Standard Mail (A) is also ineligible for DRPW sampling contributed to this problem.) Other possible reasons for the undercount were (a) not sampling Parcel Post bearing the "Bulk" payment marking because of its similarity to the Standard Mail (A) "Bulk Regular" marking; and, (b) not sampling any permit imprint Parcel Post that enters the Postal Service weighing less than a pound; this mail could be misidentified as Standard Mail (A) and would be viewed as ineligible for sampling. Tr. 43/18793 (Prescott).

In his rebuttal testimony, Mr. Glick notes that this data collection issue could easily explain the entire difference between the DRPW-only estimate and the BRPW/DRPW estimate:

In fact, if only one out of every five DRPW data collectors misinterpreted this instruction, that would explain the entire discrepancy between the two systems. Specifically, the non-permit imprint DRPW piece estimate for Parcel Post was 78 million. Tr. 2/714-715 (Pafford). Since the FY 1998 Parcel Post estimates were 266 million with the old DRPW-only system and 316 million with the new BRPW/DRPW system, Attachment to POIR No. 17, Question 7, the permit imprint estimate from the old system was 188 million while the estimate under the new system was 238 million. Because the permit imprint estimate from the old DRPW-only system is 21 percent less than the BRPW estimate, the erroneous estimate from DRPW could have resulted from 21 percent of the data collectors misinterpreting the DRPW procedures in the manner described by the Postal Service. Tr. 41/18068-18069 (Glick).

Mr. Sellick's own analysis further confirms that the discrepancy between the DRPW-only estimate of Parcel Post RPW and the BRPW/DRPW estimate must be due to a mistake in the old DRPW-only method. Specifically, Mr. Sellick shows that the DRPW-only estimate of Parcel Post RPW is consistent with the total volume of mail delivered on city, rural, and special purpose routes, and he argues that this corroborates the DRPW-only estimate. Tr. 37/16959 (Sellick). If all mail were delivered on city, rural, or special purpose routes, his assessment would be reasonable. However, as Sellick has conceded, this is not the case. Specifically, a portion of mail is delivered through "holdouts, box section, and caller service recipients." Tr. 37/16977-16979 (Sellick). Therefore, because the DRPW-only estimate is consistent with a volume estimate that excludes volumes that are delivered through holdouts, box section, and caller service recipients, it is clearly an underestimate of total Parcel Post volume. Tr. 43/18806 (Prescott).

On the other hand, the BRPW/DRPW Parcel Post estimate shows a relationship to city and rural carrier volumes that is consistent with the relationship for all mail. Specifically, Parcel Post volumes that are delivered on city or rural routes comprise 79.8 percent of the BRPW/DRPW Parcel Post volume estimate. For all mail classes, volumes that are delivered on city or rural routes comprise 78.1 percent of RPW pieces. Tr. 37/16980 (Sellick). The consistency between these two proportions strongly supports the use of the BRPW/DRPW estimate of Parcel Post volume.

IV. UPS' PROPOSED METHODS FOR DISTRIBUTING CITY CARRIER ELEMENTAL LOAD COSTS AND COSTS FOR EXCLUSIVE PARCEL POST ROUTES TO MAIL SUBCLASSES ARE WITHOUT MERIT AND THEREFORE SHOULD BE REJECTED.

In his direct testimony, UPS witness Luciani (UPS-T-5) proposed two changes to the Postal Service's established methods for distributing the costs for city carriers to mail subclasses. Specifically, he proposed that elemental load costs for parcels be distributed to mail subclasses based upon parcel weight and that the costs for Exclusive Parcel Post Routes be distributed completely to the Standard (B) Parcel Post subclass. Tr. 25/11780-11787 (Luciani). Both of his proposals are based upon severe misinterpretations of Postal Service testimony and interrogatory responses and are unsupported by the evidence presented in this case. Therefore, Mr. Luciani's proposals should be ignored and the established methods should be accepted.

A. City Carrier Elemental Load Costs for Parcels Should Be Distributed Based on Pieces, Not Weight.

As PSA witness Glick (PSA-RT-1) testified, because Mr. Luciani is not an expert on the effect of weight on elemental load costs, his proposal to distribute elemental load costs for parcels based upon weight is based primarily on USPS witness Daniel's (USPS-T-28) reexamination of this relationship:

By his own admission, Mr. Luciani is not an expert on the effect of weight on elemental load costs and performed no quantitative analysis of whether elemental load costs are a function of weight. His decision to distribute elemental load costs for parcels based upon weight therefore relies primarily on Ms. Daniel's reexamination. Tr. 41/18069-18070 (Glick).

Although Mr. Luciani said he relies on Ms. Daniel's "study," nowhere did she characterize her reexamination of assumptions as a "study." Mr. Luciani had to admit

that, whatever Ms. Daniel did, it did not equate to the engineering study that A.T. Kearney had recommended to determine the effect of weight on delivery costs. Tr. 25/11997.

As Mr. Glick further testified, Ms. Daniel's reexamination of the effect of weight on elemental load costs is insufficient for overturning an established method. First, neither Ms. Daniel nor anyone else at the Postal Service performed a quantitative study of the effect of weight on elemental load costs. Tr. 41/18070 (Glick); Tr. 4/1395 (Daniel). Second, Ms. Daniel didn't even believe that her assumption about the effect of weight on elemental load costs was accurate, stating: "I chose to allocate elemental load costs on the basis of weight, although admitting that I felt it overstated the impact that weight may play in elemental load." Tr. 4/1395 (Daniel).

For these reasons, there is no basis for distributing elemental load costs for parcels based upon weight. On the other hand, the established method for distributing elemental load costs for parcels based upon the number of parcel pieces by mail subclass is based on an accepted quantitative study. Therefore, it should be used. Tr. 41/18071 (Glick).

Furthermore, the result of Mr. Luciani's distribution method for elemental load costs defies logic. As Mr. Luciani admitted on cross examination, his proposed method would distribute more than ten times as much elemental load cost per Standard (B) Parcel Post parcel delivered than per Standard (A) parcel delivered. Tr. 38/17260 (Luciani). Common sense suggests that it simply can't take that much longer to load a Standard (B) Parcel Post parcel than a Standard (A) parcel.⁴

⁴ Also, in his rebuttal testimony, USPS witness Baron (USPS-RT-12) presented a revised study of load time that shows that large parcels take approximately 60 percent longer to load than small parcels and rolls (SPRs). Tr. 43/18707

B. Costs for Exclusive Parcel Post Routes Should Not Be Distributed Solely or Even Primarily to the Standard (B) Parcel Post Subclass. This Is Because, Despite the Poor Choice of Name, Exclusive Parcel Post Routes Are Not Dedicated Solely or Even Primarily to the Standard (B) Parcel Post Subclass.

Based primarily on its title and a brief description from a Postal Service library reference, Mr. Luciani argues that all costs for Exclusive Parcel Post Routes should be distributed to the Standard (B) Parcel Post subclass. Tr. 39/17768 (Kay). As Mr. Glick testifies, this is clearly inappropriate because only a small proportion of mail delivered on these routes is Standard (B) Parcel Post mail:

To confirm that [Standard (B)] Parcel Post pieces comprise only a small portion of volume on these routes, I analyzed the data collected for the R97-1 study and was able to confirm the Postal Service's conclusion:

- On the 32 "Exclusive Parcel Post Route" route-days examined in the study, 2,612 pieces were delivered, and only 353 (13.5 percent) of the pieces delivered were [Standard (B)] Parcel Post pieces.
- On the 32 route-days, the percentage of deliveries that were [Standard (B)] Parcel Post pieces ranged from a low of 0 percent to a high of 34 percent.
- Finally, there were 5 route-days where, out of the 421 deliveries made, none of the pieces delivered were [Standard (b)] Parcel Post pieces. Tr. 41/18071-18072 (Glick).

Furthermore, it appears that Mr. Luciani's confusion about the types of mail that are delivered on Exclusive Parcel Post Routes stemmed from the Postal Service's dual use of the term "Parcel Post." Specifically, the Postal Service at times uses the term Parcel Post to mean all parcels and at other times to only mean the Standard (B) Parcel

(Baron). Clearly, this finding is inconsistent with Mr. Luciani's allocation of ten times as much elemental load cost per large parcel (Standard (B) Parcel Post) than per SPR (Standard (A)). In fact, based upon Mr. Baron's finding, if one had

Post subclass. Tr. 39/17768-17769 (Kay). As Mr. Glick noted in his testimony, to avoid future confusion, the Postal Service should discontinue the practice of using the term Parcel Post to refer to all parcels and should rename the Exclusive Parcel Post Route type so that it reflects the variety of mail delivered on these routes and is not subject to misinterpretation. Tr. 41/18072 (Glick).

V. The Commission Should Use the Drop Ship Cost Avoidance Estimating Methods and Passthroughs Advocated by PSA Witness Glick (PSA-RT-1) to Develop Rates for the Standard (B) Parcel Post Subclass.

A. The Commission Should Use Mr. Glick's (PSA-RT-1) Cost Avoidance Model for estimating the Destination Bulk Mail Center (DBMC) cost avoidance. Should the Commission Use UPS witness Luciani's (UPS-T-5) Model, It Must Make Three Corrections to it.

The Postal Service's DBMC mail processing cost avoidance model is based on the assumption that DBMC parcels incur no outgoing, non-Bulk Mail Center (BMC) mail processing costs. Tr. 41/18072 (Glick). In his direct testimony, Mr. Luciani shows that DBMC parcels do, indeed, incur outgoing, non-BMC mail processing costs. For this reason, the Postal Service's DBMC cost avoidance model should not be used.

Mr. Glick's alternate cost avoidance model provides an appropriate solution to this problem: "Rather than assuming that DBMC parcels incur no outgoing, non-BMC mail processing costs, this DBMC cost avoidance model simply assumes that DBMC parcels incur a smaller amount of outgoing, non-BMC mail processing costs than do non-DBMC parcels." Tr. 41/18074 (Glick). This model, which produces a unit DBMC cost avoidance of 46.3 cents using an FY 1998 Base Year, should be used by the Commission to develop the DBMC cost avoidance. Tr. 41/18075 (Glick). This is

to choose between allocating elemental load costs for parcels solely based upon parcel pieces or solely based upon parcel

because this model corrects the flaw in the Postal Service model without introducing additional errors.

Mr. Luciani's DBMC cost avoidance model, on the other hand, contains three obvious errors and therefore should be rejected by the Commission. First, Mr. Luciani's model of the DBMC cost avoidance at origin sectional center facilities (OSCFs) is based primarily on a Postal Service model that the Postal Service itself views as insufficient for the task:

In addition, to use the models in Attachment A [, which are the ones that Luciani used to develop his DBMC cost avoidance,] to calculate DBMC cost savings, it would be necessary to collect detailed cost information about mail processing activities at origin SCFs....Since the models in Attachment A are currently only used to estimate the cost differences between rate categories that both go through origin SCFs, the assumptions do not have a large impact on the estimated cost differences. The estimation of the cost difference between [intra-BMC] and DBMC would result in comparing a rate category that goes through the origin SCF to one that does not. Therefore, the assumptions used to estimate the costs at the origin SCF would have a large impact on the estimated cost difference. Therefore, more information would be needed to use these models to [estimate] DBMC cost savings. Tr. 13/5167-5168 (Eggleston).

As Ms. Eggleston noted, because the OSCF model had no practical importance in the Postal Service's own estimate of Parcel Post cost avoidances, more data would need to be collected before it would be of sufficient quality for ratemaking purposes. By his own admission, Luciani did not perform this necessary data collection. Tr. 25/11978 (Luciani). Even a cursory review of the Postal Service's OSCF model confirms that it is flawed. Specifically, while this model includes costs for loading and unloading, it

weight, the most appropriate choice would be to distribute it based solely upon parcel pieces.

includes no costs for crossdocking parcels. USPS-T-26, Attachment A at 10. On the other hand, crossdocking costs comprise more than nine cents at destination SCFs.⁵

Second, Mr. Luciani failed to make the standard Cost and Revenue Analysis (CRA) adjustment to the modeled DBMC cost avoidance at origin SCFs and upstream facilities with no reasonable justification. As described in section 4.B. below, not performing a CRA adjustment has the known impact of understating the DBMC cost avoidance. Mr. Luciani further suggests that the Commission should make a non-BMC CRA adjustment to his modeled costs if it makes an adjustment at all. Tr. 25/11799 (Luciani). This is also inappropriate because the model he uses to estimate the DBMC cost avoidance clearly shows savings at BMCs as well as at non-BMCs. USPS-T-26, Attachment A at 10, 13.⁶

Third, Mr. Luciani's estimate of the DBMC cost avoidance at origin Associate Offices (OAOs) only includes cost avoidances at non-MODS facilities and in the LD43 and LD48 cost pools, Tr. 25/11798-11799 (Luciani), even though, as noted by USPS witness Degen (USPS-T-16), non-DBMC parcels do incur costs in other Function 4 cost pools:⁷ "Additionally, costs for some, not necessarily typical, parcel pieces may appear in other Function 4 cost pools [other than LD43 and LD48]." Tr. 15/6548 (Degen).

Because of these flaws, Mr. Luciani's model should be rejected. Should the Commission, however, choose to accept Mr. Luciani's model, the Commission should make the following corrections to it:

⁵ 9.35 cents crossdocking cost equals 1.78 cents for crossdocking IHCs plus 2.0 cents for crossdocking sacks in OTR plus 4.88 cents for crossdocking loose in OTR plus 2.48 cents for crossdocking OWC. USPS-T-26, Attachment A at 10.

⁶ Also, as Mr. Glick noted in his testimony, the appropriate CRA adjustment factor is Ms. Eggleston's because Mr. Luciani developed his adjustment factor based upon inconsistent data. Tr. 41/18079 (Glick).

⁷ Function 4 cost pools represent operations that occur at customer service facilities. USPS-T-16 at 12, footnote [14]

1. Include crossdocking costs at the OSCF for intra-BMC parcels.
 2. Make a CRA adjustment to the modeled portion of the DBMC cost avoidance estimate.
 3. Include outgoing costs from all Function 4 cost pools in the calculation of the OAO cost avoidance.
- B. As Discussed by PSA witness Wittnebel (PSA-RT-2), the Postal Service's Cost Model for Destination Delivery Unit (DDU) Parcels Is Correct. For Reasons Discussed by PSA Witnesses Zimmerman (PSA-T-1) and Glick (PSA-RT-1), the CRA Adjustment Should Be Applied to the Modeled DDU Cost Avoidance.**

This section describes why the Postal Service's modeled DDU cost avoidance is correct and notes that the only mistake the Postal Service made in estimating the DDU cost avoidance was failing to perform a CRA adjustment.

The Postal Service's cost model for DDU parcels assumes that these parcels avoid all unloading and sack shakeout costs at the DDU. Based upon his operational experience, Mr. Wittnebel confirms that this is correct, stating in his testimony:

[W]hen CTC [his company] enters parcels at the DDU, our drivers follow one of two procedures. If the parcels are bed loaded, our drivers separate them (by five-digit zip codes) directly into/on mail transportation equipment on the receiving dock within 20 minutes of arrival. If the parcels are palletized, our drivers remove the pallets from our trucks and place them on the dock within 20 minutes of arrival. Either way, our drivers are responsible for unloading our trucks. My understanding is that other mailers of DDU parcels follow similar procedures.

It is also worth noting that I have only described entry procedures for bed loaded and palletized parcels. This is because CTC does not enter DDU parcels in sacks. A very small percentage (less than 0.5 percent) of our DDU parcels are delivered in large plastic bags (which are used to ensure the integrity of five-digit separated parcels) and our drivers typically empty these bags upon arrival at the DDU. Again, my understanding from discussions with other mailers of DDU parcels is that they also do not enter DDU parcels in sacks. Tr. 41/18044-18045 (Wittnebel)

Furthermore, it is worth noting that Mr. Wittnebel's operational understanding of DDU entry procedures is fully consistent with Postal Service regulations. Specifically, the Postal Service's "Drop Shipment Procedures for Destination Entry" handbook clearly states:

The driver must unload all shipments within 1 hour after arrival at a DDU. At offices with responsibility for more than one ZIP Code, part of the driver's responsibility includes separating the mail by ZIP Codes if required for the shape or class of mail. Pallets must be unstacked by the driver. If the office cannot handle pallets, the driver must unload the mail into a container specified by the delivery unit. USPS-LR-I-296 at 20.

The only problem made by the Postal Service in estimating the DDU cost avoidance was that USPS witness Eggleston (USPS-T-26) did not perform the standard CRA adjustment on the modeled DDU cost avoidance with no reasonable justification. Because not making a CRA adjustment has the known impact of understating the cost avoidance, this clearly is a mistake and must be corrected. Tr. 41/18078 (Glick); Tr. 29/14144 (Zimmerman).

In his testimony, Mr. Zimmerman explains that not only is this a mistake, but it is also inconsistent with testimony Ms. Eggleston provided elsewhere in this case and that of other Postal Service witnesses:

It is also our position that the Postal Service has understated the amount of cost avoidance in DSCF and DDU because USPS witness Eggleston failed to apply the normal CRA adjustment factor for Parcel Post, even though as she elsewhere testified: "Not using some sort of CRA adjustment factors in the estimated mail processing costs would severely underestimate costs." (Tr. Vol. 13, pp. 5109-10) It seems obvious to us that, just as failing to make the CRA adjustment would understate parcel costs, it will also have the effect of understating the amount of costs that are avoided through drop shipping. The Postal Service's position is that the CRA adjustment should not be made to modeled costs for a new subclass of mail but only be applied to well-established subclasses. Apparently the justification is that, with a new

subclass, the data is sufficiently sparse so that it creates the possibility of error or rather the possibility of overstating the amount of cost avoidance. While that may be true it seems to us that to fail to make the adjustment far more likely guarantees that the amount of cost avoidance will be underestimated.

USPS witness Daniel, who used Ms. Eggleston's cost models for DDU and DSCF realized that she did have to make a CRA adjustment to witness Eggleston's cost model in order to get the correct total. Tr. 29/14144 (Zimmerman).

C. Just as it Did in Docket No. R97-1, the Postal Rate Commission Should Continue to Pass Through Nearly 100 Percent of Destination-Entry Cost Avoidances.

In Docket No. R97-1, the Postal Rate Commission passed through nearly 100 percent of Parcel Post destination-entry cost avoidances in the form of discounts. Tr. 32/15719 (Glick). Consistent with this precedent and the Commission's longstanding approach of "gradually increasing levels of passthrough as improved cost estimates become available," PRC Op. R97-1, para. 5525, the Commission should again pass through nearly 100 percent of destination-entry cost avoidances in the form of discounts. Furthermore, no party has provided a reasonable justification for passing through less. This section explains why the arguments presented by UPS witness Luciani (UPS-T-5) do not justify lower passthroughs.

Mr. Luciani argues that the passthrough of the DDU cost avoidance should be set to ensure that the implicit markup on DDU parcels is set equal to the explicit markup on Priority Mail. Mr. Luciani estimates that this method would result in a passthrough of the DDU cost avoidance of approximately fifty percent. His justification is that DDU parcels and Priority Mail receive similar handling at the delivery unit. Tr. 25/11805-11806 (Luciani). As Mr. Glick notes, this concept is flawed for two primary reasons and therefore should not be used:

- Anomalies would be common practice. Because of differences in handling practices between DDU parcel and DSCF parcels, the DDU rate could actually be higher than the DSCF rate, an anomalous result indeed. Tr. 41/18083-18084 (Glick).
- Mr. Luciani's method assigns markups to rate categories based solely on value of service, a method that is inconsistent with the Postal Reorganization Act's criteria for setting markups. As Mr. Glick notes, Luciani's argument is analogous to arguing that "Standard (A) Nonprofit and Standard (A) Regular should have the same markup because they receive a similar intrinsic value of service and that Periodicals should have a higher markup than Standard (A) because Periodicals mail receive a higher intrinsic value of service than Standard (A) mail. Neither of these outcomes would be reasonable based upon an analysis of all of the noncost criteria." Tr. 41/18084 (Glick).

Mr. Luciani further argues that the passthrough for DDU parcels should be constrained because his bottom-up cost model generated a cost that was higher than that implicit in the Postal Service's DDU rate. Tr. 25/11807 (Luciani). But as Mr. Glick testifies, the discrepancy vanishes once one correction is made to Mr. Luciani's model. Tr. 41/18086. After the additional corrections that were described by Amazon witness Haldi (AMZ-RT-1) and USPS witness Kay (USPS-RT-13) are made, Luciani's model produces a cost estimate that is significantly less than that implicit in the Postal Service's DDU rate. Tr. 44/19551 (Haldi); Tr. 39/17802 (Kay). Therefore, because Mr. Luciani's model is wrong, his argument is moot.

VI. The Postal Service's Method for Distributing Nonpriority Alaska Air Costs to Rate Category Is Appropriate.

As described by PSA witness Glick (PSA-RT-1), USPS witness Eggleston (USPS-T-26) estimated nonpriority Alaska Air costs for DSCF and DDU parcels by assuming that local transportation costs for DSCF and DDU parcels that destinate in Alaska would incur the usual transportation costs incurred by DSCF and DDU parcels that don't destinate in Alaska. Tr. 41/18080 (Glick). This is appropriate and is consistent with the Commission's principle for distributing nonpriority Alaska Air costs to mail subclasses:

Congress has made a determination to have universal mail service. Part of that mandate is to offer the same rates to each person in the country. Costs which are found to have been incurred solely to meet that mandate, however, are caused by the statute and not by any particular class of mail. **Those costs, moreover, should not be permitted to distort the rates and services supplied to all the country.** Costs which are not caused by Parcel Post should not be allocated to that subclass. Furthermore, it is neither rational nor reasonable that rates paid by Priority Mail -- which is constrained by the Private Express statutes for part of its volume -- should be affected by the necessity to fly Parcel Post to remote areas of Alaska.

Some Parcel Post users argue that none of the costs from nonpriority air should be attributed to their subclass. However, those parcels are being transported to a domestic delivery address, and it is appropriate that the **usual** costs of transportation be included in the rate base (emphasis added). PRC Op. R90-1, para. 3769-3770.

UPS witness Luciani's (UPS-T-5) proposal for distributing nonpriority Alaska Air costs, on the other hand, violates the Commission's principle and also boils down to double counting. As described by Mr. Glick, Mr. Luciani's method "distorts the rates and services supplied to all the country" by doubling the unit transportation cost of all DDU parcels. Tr. 41/18081 (Glick). Also, by explicitly allocating nonpriority Alaska Air costs

to the DDU and DSCF rate categories above and beyond the allocation of costs already made by Ms. Eggleston, Mr. Luciani assigned nonpriority Alaska Air costs to DDU and DSCF parcels twice. Tr. 41/18082 (Glick).

VII. THE POSTAL SERVICE HAS OVERSTATED THE COST OF OVERSIZED PARCELS BY OVERESTIMATING THE AVERAGE CUBE OF AN OVERSIZED PARCEL. THIS MUST BE CORRECTED.

The Postal Service's cost estimates for oversized parcels (and therefore the rates for these parcels) are overstated because the Postal Service failed to accurately quantify the average cube of oversized parcels. Tr. 23/10811-10813 (Karls). As Mr. Karls notes, the fact that the Postal Service did, in fact, overestimate this average cube is obvious from analysis of the theoretical maximum and minimum size of oversized parcels and from a comparison of the Postal Service's estimate with the average cube of oversized parcels of Fingerhut and CTC:

There is a theoretical maximum and minimum amount of cubic feet to a parcel whose combined length and girth are between 108" and 130". The Postal Service agreed that the theoretical maximum was 11.77 cubic feet and that, if one constrained it so that the length could not be more than 5 times the girth, and that the cross-section has to be square, the minimum density would be 1 cubic feet. Thus, it is obvious that the Postal Service's estimates [of approximately 8 cubic feet] based on their skimpy sample are on the high side of this range of 1 to 11.77 cubic feet. The mean of these extreme dimensions would be around 6 cubic feet....

Based on the real world experience of our own mailings, and that of a major shipper with whom we consulted, the density of oversize parcels is much closer to 6 feet than it is to the Postal Service's revised 8.04 cubic feet. Tr. 10811-10812 (Karls).

As Mr. Karls further notes, the primary reason for the Postal Service's misestimate of the average cube of an oversized parcel is the small sample size that the Postal Service used. Specifically, the Postal Service estimated the average cube based upon a sample of only 64 parcels, only five of which were intra-BMC. Tr. 23/10811 (Karls). This clearly is insufficient.

Therefore, PSA recommends that the Commission estimate the unit cost for oversized parcels based upon the average cube data provided by Fingerhut and CTC. These data, which are based upon a sample that is much larger than the Postal Service's entire oversized parcel volume, indicate that the average cube of an oversized parcel is approximately 6 cubic feet. Tr. 23/10812-10813 (Karls).

VIII. THE PRC SHOULD REJECT THE REQUESTED 80 PERCENT INCREASE IN THE SHAPE BASED SURCHARGE ON STANDARD A PARCELS.

A. There Is Neither Law Nor Regulatory Precedent That Requires The Implicit Coverage For One Type Of Standard A Mail To Be Greater Or Lesser Than The Implicit Coverage For Another Type Of Standard A Mail Within The Same Rate Category

The Postal Service has still failed to justify carving out a portion of a rate category for special surcharge treatment. And the presumed justification for such a surcharge, that is, that it will help the rest of the rate category avoid higher rates than would otherwise have to be paid in the absence of a surcharge, lacks support from the intended beneficiaries, Standard A flat mailers. Tr. 29/14137-8 (Zimmerman) Of course, the Standard A flat mailers are also the very same people who are mailing Standard A parcels.

What the Postal Service has sought to do through the surcharge, in effect, is to create a new separate subclass of Standard A parcels without going through the regulatory rigors to do so.

As PSA witness Zimmerman points out, comparing the cost of Standard A flats and parcels is like comparing apples and oranges. The Standard A flats and parcels are not even in the same rate category as are three other sets of Standard A flats and parcels. The Postal Service has once again combined four different subclasses, each of which contains flats and parcels, and hit them all with one single surcharge by amalgamating the costs of mail types within those four different subclasses. Tr. 29/14140 (Zimmerman)

B. The Postal Service Has Failed To Take Into Account The Demonstrably Greater Revenues Per Piece Raised By Parcels Compared To Flats

The Postal Service has once again tried to obscure the true relationship between parcels and flats. The Service emphasizes its belief that a parcel costs considerably more to process than a flat; even if true, a parcel also produces substantially more revenue than a flat. Tr. 29/14140 (Zimmerman)

Even if one accepts Postal Service cost data, for purposes of argument, the cost-revenue gap for a parcel, after effectuating the 80 percent increase in the surcharge, would only be the difference between costs of 79.17 cents and revenues of 70.8 cents, a little over 8 cents per piece cost difference. *Id.* at 14140. The Postal Service's antidote of an 80 percent increase is simply disproportionate to the size of the problem. With no increase in the surcharge whatsoever parcels would still contribute 62.8 cents revenue per piece to cover costs of 79.17 cents, a cost coverage of about 80 percent.

That coverage compares favorably to the coverages of vast quantities of mail, particularly certain types of First-Class single piece letter mail, the volume of which is far greater than the volume of Standard (A) parcels. Id. at 14140.

C. An 80 Percent Increase In A Rate Contravenes Criterion Four of The PRA.

Given the relatively small size of the Standard A parcel market and the relatively small contribution that this 18 cent surcharge will make toward mitigation of the coverage burden of the Standard A subclass, or even Standard A non-letters as a rate category, there is no justification under criterion four for imposing an 80 percent increase. This is even more so the case given the fact that Postal Services cost estimates, on their face, are preposterous for certain portions of the Standard A parcel group.

The Postal Service had no rational explanation for their absurd finding that a non-profit ECR parcel cost three times as much as a regular parcel to process. Tr. 8/3425 (?). The claimed cost increase for all Standard A parcels since the 1996 base year is an amount that defies credibility. Id. The Postal Service claim that the data on parcels and flats has been consistent from year to year is mocked by the actual facts. Their own data show that contention to be the exact opposite. It shows that Standard A parcels cost 52 cents per piece in FY 1993, 57 cents in 1994, 54 cents in 1995, and back to 52 cents in 1996. Granted there is some consistency for those four years. However, for base year 1998, parcel costs go from 51.6 cents in 1996 to 78 cents, over a 51 percent increase in two years. The Postal Service was completely unable to explain how Standard A parcel costs had jumped 50 percent. Tr. 8/3501-4 The data

flatly contradicts their contention that parcel costs have been consistent from year to year, and that should seriously undermine its credibility.

IX. STANDARD A BAR CODE DISCOUNTS SHOULD BE RECOMMENDED.

The Postal Service proposal for a 3 cent discount for bar coded Standard A parcels should be approved because it is deserved. Bar coding Standard A parcels has the same cost minimizing effect as the bar coding on Standard B parcels; there is no rational justification for not extending the discount to Standard A parcels. The Postal Service would also have the Commission believe that, through this act of generosity, there is a mitigation to the 80 percent increase in its proposed surcharge for Standard A parcels. The two have nothing to do with each other; the discount is earned and the surcharge is unwarranted.

X. THE PROPOSED INCREASES FOR PRIORITY MAIL AND BOUND PRINTED MATTER ARE EXCESSIVE.

Parcel shipper members are using an increasingly significant amount of priority mail. A 15 percent increase for a subclass that already has such high cost coverage cannot be justified, nor can it be explained except as the Service's naïve hope that they can charge what the traffic will bear. Tr. 29/14135 (Zimmerman). An increase of those dimensions will have predictable results:

1. The Postal Service will lose market share to the aggressive tactics of its competitors.
2. Such high rates will create an umbrella under which USPS's competitors will be able to significantly increase their own rates, with very serious damage to consumers and to the competitive process. Id.

The Bound Printed Matter subclass is also of consequence to several of PSA's members. An increase of 18.15 percent is so large that it is clear on its face that the Postal Service gave no consideration whatsoever to the ESCI value of Bound Printed Matter. Tr. 29/14136 (Zimmerman)

XI. AS PSA WITNESS ZIMMERMAN (PSA-T-1) TESTIFIED, THE POSTAL SERVICE SHOULD OFFER THE ELECTRONIC DELIVERY CONFIRMATION SERVICE FOR FREE. AT A MINIMUM, IT SHOULD BASE ITS FEE ON THE MORE REASONABLE COST ESTIMATES PROVIDED BY USPS WITNESS DAVIS (USPS-RT-21) IN HIS REBUTTAL TESTIMONY.

Just as the Postal Service offers the delivery confirmation service for free to Priority Mail users with electronic manifest, it should offer this same service for free to Parcel Post users with electronic manifest. Tr. 29/14141-14142 (Zimmerman). As Mr. Zimmerman testified, this service should be offered free of charge for two reasons. First, the cost is minimal:

[T]he equipment costs have already been incurred and we are simply talking about a question of utilization of that equipment plus whatever added variable labor costs that may be involved in order to scan and transmit. Tr. 29/14141-14142 (Zimmerman).

Second, the Postal Service can use the information from delivery confirmation to better manage its internal operations, thus offsetting the minimal costs for scanning and transmitting:

Moreover, there is a real question whether this should be standard operating procedure for the Postal Service internally to know what is going on. Tr. 29/14142 (Zimmerman).

At a minimum, the Commission should base its fee for the electronic delivery confirmation service on the 7.9-cent unit cost that Mr. Davis developed using less conservative cost estimating assumptions presented by Mr. Davis in his rebuttal

testimony. Tr. 39/17427-17431 (Davis). While PSA believes that Mr. Davis's revised assumptions still overstate the cost of the service, his analysis is clearly a step in the right direction. Certainly, there is no cost justification for an electronic delivery confirmation fee that exceeds 10 cents.

Third, the lesson is obvious in the case of priority mail. The Postal Service acknowledges that free delivery confirmation service for priority mail generated 140 million dollars of additional revenues because the confirmation service attracted that much new priority mail business. (29/14142). Postal Service competitors provide this type of service for free. It is foolish for the Postal Service to further handicap itself by charging for what its competitors are giving away for free, and at the same time denying itself the type of internal information it needs to manage properly. (Id.). As the Postal Service has admitted there is relatively little, if any, use of this service at the 25 cent fee. (Id. at 14141).

XII. THE REVENUE REQUIREMENT IS EXAGGERATED, DUE LARGELY TO AN EXCESSIVE CONTINGENCY.

The Postal Service, even using updated FY 1999 costs as the base year costs in this proceeding, has failed to justify all of the revenue it requested.

Although the Postal Services anticipated has worsened, due to the use of FY 1999 cost data as the base, the actual deficit for the test year is still almost 2 billion dollars less than the revenues requested. This additional money is asked for in order to cover adverse contingencies and to amortize prior losses. (29/14129). While being given numerous opportunities to do so, during several stages of the proceeding, the Postal Service failed to offer a credible explanation of why, after successfully operating

in the black over the last two rate cycles with rate increases that were less than the rate of inflation, it is now necessary to receive rate increases that are twice the rate of inflation.

As witness Zimmerman pointed out, the estimated costs for FY 2000 and 2001 are cumulatively 2.7 percent greater than the estimated CPI-W for those two years. (Id. at 14130). The fact that the Postal Service has been able to operate in the black during the previous two rate cycles with rate increases that cumulatively were 5 percent less than inflation is, by itself, conclusive proof that the Postal Service does not need increases that greatly exceed the rate of inflation, absent some extraordinary explanation suggesting dire unforeseen possibilities are likely to happen. We are no longer the ratemaking era where there was a wink and a nod because the rate cycles were to last at least three years and, therefore, the contingency was needed to get the Postal Service through the third year without suffering losses. Current rate cycles are more likely to be of the two year variety; and, in a period when there is little inflation and better forecasting because of the shorter cycles, there simply is no longer a case to be made for large contingencies. In fact, the case that can be made is that large contingency allowances by themselves help bring about a self-fulfilling prophecy of red ink because they have a chilling effect on volume growth; encourage a less efficient management cushioned by the availability of several billion extra dollars; and encourage the postal work force to ask for a bigger share of that extra revenue that is just lying around unused.

PSA witness Zimmerman put the question succinctly:

One must ask why would the Postal Service jeopardize this very successful formula of small to moderate increases, and why would they think the Commission would want to risk a return to the era in

which very large postal rate increases had the predictable effect of killing volume, thereby spreading non-variable institutional costs over a smaller base, with resultant adverse revenue effects and an almost unbroken string of deficits? Tr. 29/14129-14130 (Zimmerman).

On the other hand, the updated cost and revenue numbers do suggest that the Postal Service could not afford a loss of revenue that would be the equivalent of denial of the 1 cent increase in First-Class rates. Every class and subclass of mail has a reasonable expectation of some benefit from a reduction of the Postal Service's revenue requirement. Denial of the 1 cent increase for First-Class would by itself consume all of a reasonable reduction in the Postal Service's revenue allowance. That would be unfair to all other classes and subclasses of mail. And, cutting the revenue requirement by enough to treat other subclasses fairly and also eliminate a 1 cent increase in basic First-Class letter rates would, in our opinion, be irresponsible; it would trigger the next round of rate increases far sooner than is healthy and far sooner than customers can adapt to such rate changes.

The Commission needs to wield a careful surgical scalpel in pruning the Postal Service's request; a meat axe is not called for in this case.

PROPOSED FINDINGS AND CONCLUSIONS

1. The Commission finds that the Parcel Post proposed coverage of 115.1% is excessive; there is no justification shown for coverage that exceeds the 109% recommended by the Commission in R97-1;
2. The Commission finds there is little competition in the ground parcel delivery market, and that Parcel Post must be priced so that it remains a viable

competitor in order to observe the injunction of the Postal Reorganization Act to preserve competition;

3. The Commission finds no basis for increasing the overall level of Parcel Post rates above the current level, since the current level of rates already exceeds the cost coverage for the sub-class that the Commission would otherwise recommend;

4. The Commission finds that the Postal Service's joint use of the Revenue Pieces and Weight system (BRPW) and the Domestic Revenue and Pieces and Weight system (DRPW) produces more accurate estimates of Parcel Post revenue, pieces, and weight.

5. The Commission finds that the USPS revenue, pieces, and weight estimates for Parcel Post for the test year before and after rates is the more reliable estimate.

6. The Commission finds that analysis of postage statement-level data does not indicate that BRPW contains significant errors;

7. The Commission finds that the trial balance revenue for FY-1999, PQ 3 and 4, shows the BRPW estimate of permit imprint Parcel Post is more accurate than the DRPW-only estimate;

8. The Commission finds that the inclusion of parcels weighing less than one pound mailed at Parcel Post rates did not cause an overstatement of BRPW estimates of permit imprint Parcel Post revenue;

9. The Commission finds that it is very unlikely that permit imprint pieces being recorded as metered pieces in DRPW cause significant bias;

10. The Commission finds that the Postal Service explanation of the error in the DRPW-only estimate is a reasonable explanation.

11. The Commission finds that the Postal Service has correctly distributed city carrier elemental load cost on the basis of pieces rather than weight.

12. The Commission finds that the Postal Service correctly distributed the costs of a category called "Exclusive Parcel Post routes;" despite the misnomer, "Exclusive Parcel Post routes" are not dedicated solely, or even primarily, to Parcel Post, and, therefore, the cost should not be exclusively attributed to Parcel Post.

13. The Commission finds that the cost avoidance model for estimating the destination BMC cost avoidance is best estimated by PSA witness Glick.

14. The Commission finds that the Postal Service's cost model for destination delivery unit (DDU) parcels is correct, but further finds, as it did in Docket R97-1, that the appropriate pass through of destination-entry cost avoidance is roughly 100%.

15. The Commission finds that the Postal Service correctly distributed nonpriority Alaska air costs to rate categories.

16. The Commission finds that the Postal Service has overestimated the average cube of over-sized parcels, and therefore has overstated the costs, leading to excessive rates for over-sized parcels.

17. The Commission finds that the proposed 80% increase in the shape-based surcharge for Standard (A) parcels is unwarranted; not justified under the Act; and in contravention of criterion four, the impact on the users.

18. The Commission concludes that it is unnecessary to require mail types within the same rate category to meet the same implicit cost coverages and, as a matter

of policy, declines to establish equal coverages within a rate category as a regulatory goal.

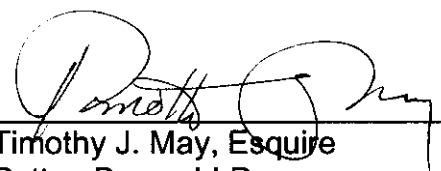
19. The Commission finds that the proposed discount for bar coding Standard (A) parcels is warranted, based on the cost avoidance from such bar coding.

20. The Commission finds that there is no cost justification for a 15% increase in priority mail; and, furthermore, finds that such an increase would disable the Postal Service in its efforts to compete in the priority mail market, all to the disadvantages of consumers and to the competitive process.

21. The Commission finds that there is no cost or pricing justification for an electronic delivery confirmation service fee in excess of 10 cents per piece.

22. The Commission finds that the Postal Service has exaggerated the revenue requirement, due largely to a request for an excessive contingency allowance.

Respectfully submitted,



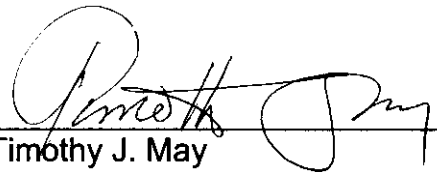
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Dated: September 13, 2000

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing upon all participants of record in this proceeding in accordance with Section 12 of the Rules of Practice.



Timothy J. May

Dated: September 13, 2000